

# Audits, Standards, Limitations, & Cohort Default Rates

## CHAPTER 4

*Schools that participate in the FSA programs are generally required to have annual compliance and financial statement audits. This chapter will discuss the audit requirement and the financial standards and limitations that apply to a school's FSA eligibility. In addition, we will discuss the annual calculation of a school's cohort default rate.*

### FSA AUDIT REQUIREMENTS FOR SCHOOLS

A school that participates in any FSA program, including a participating foreign school, generally must have an independent auditor conduct an annual audit of the school's compliance with the laws and regulations that are applicable to the FSA programs in which the school participates (a compliance audit) and an audit of the school's financial statements (a financial statement audit).

While a compliance audit covers the school's administration of the FSA programs, a financial statement audit provides the Department with information necessary to evaluate a school's status *vis-a-vis* the financial standards that are discussed later in this chapter.

The type of compliance audit a school or servicer must undergo depends on its type of control: public, for-profit, or nonprofit.

- ♦ All for-profit schools must have an FSA compliance audit conducted under the Inspector General's *Audit Guide* (for FSA school audits), which is available on the IFAP website.
- ♦ Public and nonprofit schools must comply with the Single Audit Act. The Single Audit Act requires these schools to have an audit conducted in accordance with the Office of Management and Budget's (OMB) Circular A-133, Audits of States, Local Governments, and Nonprofit Organizations. (Circular A-133 allows an FSA compliance audit under the criteria of the *Audit Guide* under limited circumstances.)

The Office of Inspector General (OIG) also conducts audits, usually in cases where there is concern over a school's administration of the FSA programs. An OIG or other federal audit does not satisfy the requirement that a school have annual compliance and financial statement audits performed by an independent public accountant.

Note that audit requirements also apply to third-party servicers. However, a school may never use a third-party servicer's audit in place of its own required audit because the school is ultimately liable for its own violations as well as those incurred by its third-party servicers.

#### Related information

- Administrative requirements, Chapter 3
- Program reviews, Chapter 8

#### School participation divisions

For information regarding accounting and compliance issues, a school should contact the school participation division for its region. Go to the IFAP website ([ifap.ed.gov](http://ifap.ed.gov)) > Help > Contact Information > Federal Student Aid Offices > School Participation Division

**NEW**

#### Single Audit Act Not Applicable

The Higher Education Act requires each Title IV participating institution to submit to the Department a financial audit and a compliance audit on at least an annual basis. Both the HEA and the implementing regulations require annual submissions of not only the institution's audited financial statements but also of the compliance audit of the institution's administration of the Title IV student aid programs. Therefore, a submission prepared under the Single Audit Act requirements that does not include a compliance audit does not meet the HEA audit requirement.

EA 2016-08-05

#### Audit requirements & waiver

HEA: Sec. 487(c)  
20 USC 1094  
34 CFR 668.23(a)(1) to (5)  
Waiver: 34 CFR 668.27

## TIMING OF AUDIT SUBMISSIONS

### *Simultaneous FSA audit submissions*

#### **Independent CPA/auditor**

An independent certified public accountant or government auditor, except that a government auditor must meet the Government Auditing Standards qualification and independence standard, including standards related to organizational independence.

A school that has an audit performed under the *Audit Guide* for FSA schools must submit both the compliance audit and the audited financial statements within six months of the end of the school's fiscal year. Both audits must be prepared by an independent public accountant in accordance with the Generally Accepted Accounting Principles (GAAP) and audited in accordance with the Generally Accepted Government Auditing Standards (GAGAS). The compliance audit and financial statement audit may be performed by different auditors. However, the audits must be submitted as one package.

Both the compliance audit and the financial statement audit must be performed on a fiscal-year basis. In cases where the school's fiscal year does not coincide with an award year, the school's compliance audit will cover parts of two award years (see example).

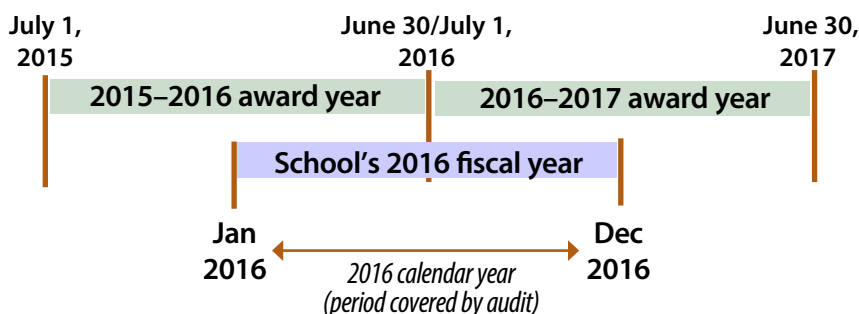
#### **Opportunity to send comments to Small Business Ombudsman**

The Small Business and Agriculture Regulatory Enforcement Ombudsman and 10 Regional Fairness Boards were established to receive comments from small businesses about federal agency enforcement actions. The Ombudsman annually will evaluate the enforcement activities and rate each agency's responsiveness to small business. If you wish to comment on the enforcement actions of the Department of Education, call 1-888-REG-Fair (1-888-734-3247).

#### **Fiscal year for 2016–2017**

For schools using a calendar year as their fiscal year, their most recently completed fiscal year is the one that ends on December 31, 2016. For those schools using the award year as their fiscal year, their most recently completed fiscal year will be the one that ends on June 30, 2017.

### Example: school's fiscal year ≠ FSA award year



### *Submission dates for FSA audits*

A school's or servicer's annual compliance and financial statements audits performed under the *Audit Guide* must be based upon the fiscal year and submitted to the Department within six months after the end of the school's or servicer's fiscal year. (These requirements do not apply to audits performed under the Single Audit Act that are due as specified in OMB Circular A-133.)

The chart on the next page lists audit due dates and the period the audit must cover. (The chart provides information for the most common institutional fiscal-year-end dates.)

Generally, a school's first audit performed under these requirements must cover the entire period of time since the school began to participate in the FSA programs. Each subsequent audit must cover the period since the end of the period covered by the preceding audit that is accepted by the Department.

Audit submission due dates	School's fiscal year end date		Both audits due		Period audited (financial and compliance)
	September 30, 2016	➡	March 31, 2017	➡	October 1, 2015, through September 30, 2016
	December 31, 2016	➡	June 30, 2017	➡	January 1, 2016, through December 31, 2016
	March 31, 2017	➡	September 30, 2017	➡	April 1, 2016, through March 31, 2017
	June 30, 2017	➡	December 31, 2017	➡	July 1, 2016, through June 30, 2017

### Waivers of requirement for an annual FSA audit

A school may request a waiver of the requirement for an annual audit for up to three years. A proprietary school must have disbursed less than \$200,000 in each of the two most recently completed award years to be eligible for the waiver, and the school must also meet the other regulatory conditions in 34 CFR 668.27. A public or private nonprofit institution that expends less than \$750,000 in federal funds in a fiscal year is exempt from filing compliance audits after the school gains initial eligibility.

If a waiver is approved, at the end of the waiver period, the school must submit a compliance audit covering each individual fiscal year in the waiver period and a financial statement audit for the last year of the waiver period.

This exception to the annual audit requirement may not be granted for the award year preceding a school's required recertification.

### Audits required at end of waiver period

The regulations do not waive the requirement that a school audit its administration of the FSA programs; they waive the requirement that these audits be submitted on an annual basis. Therefore, if a school is granted a waiver for three years, when the waiver period expires and the school must submit its next compliance audit, that audit must cover the school's administration of the FSA programs since the end of the period covered by its last submitted compliance audit.

The auditor for a proprietary school must audit, and attest to, the school's annual 90/10 determination for each individual year in the waiver period (in accordance with 34 CFR 668.23(d)(4)).

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**Rescinding the waiver**

The Department rescinds a waiver if the school:

- disburses \$200,000 or more of FSA program funds for an award year;
- undergoes a change in ownership resulting in a change of control; or
- becomes the subject of an emergency action or a limitation suspension, fine, or termination action initiated by the Department or a guaranty agency.

If the Department grants the waiver, the school does not have to submit its compliance or audited financial statement until six months after

- ♦ the end of the third fiscal year following the fiscal year for which the school last submitted a compliance audit and audited financial statement, or
- ♦ the end of the second fiscal year following the fiscal year for which the school last submitted compliance and financial statement audits if the award year in which the school will apply for recertification is part of the third fiscal year.

A school's waiver request may include the fiscal year in which that request is made, plus the next two fiscal years.

A school remains liable for repaying any FSA funds it improperly expends during the waiver period. A compliance audit is the vehicle for discovering improper expenditures. Therefore, a school will be required to pay any liabilities when the school eventually submits a compliance audit for the fiscal years in which it made improper expenditures.

## Qualifying for and Effects of Waivers

### Qualifying for a waiver

To qualify for a waiver, a school must demonstrate that it:

- is not a foreign school;
- disbursed less than \$200,000 in FSA program funds during each of the two completed award years prior to the audit period;
- agrees to keep records relating to each award year in the unaudited period for two years after the end of the regular record retention period for the award year;
- has participated in the FSA programs under the same ownership for at least three award years preceding the school's waiver request;
- is financially responsible under the general requirements of financial responsibility and does not rely on the alternative standards and requirements of exceptions to participate in the FSA programs;
- is not receiving funds under the reimbursement or cash monitoring system of payment;
- has not been the subject of a limitation, suspension, fine, or termination proceeding, or emergency action initiated by the Department or a guaranty agency in the three years preceding the school's waiver request;
- has submitted its compliance audits and audited financial statements for the previous two fiscal years, and no individual audit disclosed liabilities in excess of \$10,000; and
- submits a letter of credit in the amount as determined below, which must remain in effect

### Effects of waivers—examples

Example 1: The school is still required to have its administration of the FSA programs audited for the waiver period. If a school is granted a waiver for three years, when the waiver period expires, the next audit must cover the school's administration of the FSA programs since the end of the period covered by its last submitted compliance audit. For example, if a school's fiscal year coincides with an award year (July 1–June 30) and it submits a compliance audit for its fiscal year that ends on June 30, 2016, and then receives a waiver, its next compliance audit is due six months after the end of its 2018–2019 fiscal year. When it submits that audit, it must cover the 2016–2017, 2017–2018, and 2018–2019 fiscal years.

Example 2: If a school's fiscal year ends June 30, 2016, and the school receives a waiver on May 1, 2016, that includes the 2016–2017, 2017–2018, and 2018–2019 fiscal years, the next compliance audit is due six months after the end of the school's 2018–2019 fiscal year.

## STANDARDS AND GUIDELINES FOR FSA AUDITS

### *Audited financial statement requirement*

#### **Audit guide (for FSA programs)**

The official title of the Inspector General's audit guide for the FSA programs is *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers*.

The audit guide is available on the IFAP website ([ifap.ed.gov](http://ifap.ed.gov)) under "Publications."

The G5 Users Guide is available at ([www.g5.gov/](http://www.g5.gov/)).

A school's audited financial statement must cover the school's most recently completed fiscal year. The Department uses the information in a school's audited financial statement to evaluate the school's status *vis-a-vis* the financial standards discussed in this chapter. In addition to a school's audited financial statement, the Department may require that the school submit additional information. For example, the Department may require a school to submit or provide access to the auditor's work papers. Also, if the Department finds it necessary to evaluate a particular school's financial condition, the Department can require a school to submit audited financial statements more frequently than once a year.

### *FSA compliance audits*

Compliance audits must be conducted in accordance with the general standards and the standards for compliance audits contained in the U.S. General Accountability Office's (GAO's) Government Auditing Standards. In addition, the auditor should use the following guidance, based on school type:

- ◆ OMB Circular A-133 for public and private nonprofit schools audited under the Single Audit Act
- ◆ the latest *Audit Guide* for the FSA programs (see sidebar) for for-profit schools, foreign schools, and third-party servicers

In conducting an audit, the auditor may also find it useful to consult the accounting and record keeping guidance in the FSA Handbook and the *G5 Users Guide*, as applicable.

A school (or third-party servicer) may use the same independent auditor or auditing firm for its required nonfederal audit as the one that usually audits its fiscal transactions. To produce unbiased conclusions, the auditor must be independent of those authorizing the expenditure of FSA funds.

The Department may require a school to provide a copy of its compliance audit report to guaranty agencies, lenders, state agencies, other federal agencies, or accrediting agencies.

#### **Financial statements, accrual basis, and GAAP standards**

Financial statements must be prepared on an accrual basis in accordance with generally accepted accounting principles (GAAP) and audited by an independent auditor in accordance with GAGAS and other guidance contained in OMB Circular A-133, or in the Department's *Audit Guide* (for FSA school audits).

## Single Audit Act (A-133 audit) guidelines

Nonprofit and public schools are required to have audits performed under the guidelines of the Single Audit Act. (These audits are also known as “A-133 audits” because the audit guidelines are established in OMB Circular A-133). A-133 audits satisfy the Department’s audit requirements.

A-133 audits have distinct auditing and submission requirements and must be submitted to the Federal Audit Clearinghouse. (A copy of the audit must also be submitted to the Department through the eZ-Audit website.) A school submitting an audit under the guidelines of the Single Audit Act must use the submission deadlines established by the Single Audit Act.

### Exemptions

A school that expends less than \$750,000 of federal funds during a fiscal year is exempt from submitting an annual A-133 audit. However, a school that spends less than \$750,000 in all federal funds is still required to submit a financial statement to the Department within six months after the close of its fiscal year. The financial statement does not have to be audited by a CPA and may be created as compiled or reviewed statements. If the school has prepared a set of audited financial statements for its own use or for another entity, the school must submit those audited financial statements to the Department no later than six months after the end of the institution’s fiscal year.

Circular A-133 permits the submission of program-specific audits if an entity expends funds in only one federal program *and* the program’s regulations do not require a financial statement audit. The FSA program regulations require a financial statement audit. Therefore, a school may not submit a program-specific audit to satisfy the Department’s audit submission requirements.

Circular A-133 also now allows an independent auditor to use professional judgment to determine whether certain federal programs must be included in the scope of an audit. An independent auditor can exclude certain program components, such as FSA program funds, if they fall below a predetermined dollar and risk threshold.

The independent auditor must make an annual assessment of the dollar and risk conditions and determine whether such exclusions are appropriate and whether any FSA programs must be included within the scope of the audit. You can find additional information on this topic in the latest Compliance Supplement to Circular A-133.

### Submitting A-133 audits

The Form SF-SAC and the Single Audit Reporting packages for fiscal periods ending on or after January 1, 2008, must be submitted online to the Federal Audit Clearinghouse.

[harvester.census.gov/facweb/](http://harvester.census.gov/facweb/)

### Annual financial statement

Section 487(c) of the HEA provides that all schools participating in the Federal Student Aid programs must submit *annual financial statements* to the Department. This applies to all schools, including nonprofit schools that are otherwise exempt from submitting annual audited financial statements under the A-133 standards.

### Circular A-133 and the Single Audit Act

Office of Management and Budget (OMB) Circular A-133 was issued pursuant to the Single Audit Act of 1984. The Single Audit Act was amended in 1996—the current requirements are found in Chapter 75 of title 31, U.S. Code.

Circular A-133 is titled “Audits of States, Local Governments, and Nonprofit Organizations” and is applicable to nonprofit postsecondary schools, states, local governments, and Indian tribal governments. For many schools, this is a combined audit of all the federal programs at that school. OMB circular A-133 is available through the OMB homepage at

<https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/circulars/A133/a133.pdf>



## FSA consolidated statements

### 90/10 Rule

Guidance on footnote disclosures can be found in the *FSA Audit Guide*, in 34 CFR 668.23(d)(4), and in appropriate accounting references.

See DCL GEN-08-12 for changes made by the *Higher Education Opportunity Act of 2008* (section 493), moving 90/10 rule to the Program Participation Agreement (from the definition of a proprietary institution of higher education).

Earlier guidance on 90/10 and institutional loans and scholarships can be found in Dear Partner Letter GEN-99-33 and Dear CPA Letters CPA-99-01 and CPA-99-02.

HEA section 487

34 CFR 668.14(b)(16)

34 CFR 668.28

In some cases, a school's relationship with another entity may cause the Department to require a school to submit additional financial statements both of the school and the entity, such as audited consolidated financial statements; audited full consolidated financial statements; audited combined financial statements; or, under certain circumstances, audited financial statements of one or more related parties. This occurs when the Department determines that the activities or financial health of another entity may impact the school's total financial health. So that the Department can make this determination, a school must include in its audited financial statements a detailed description of related entities based on the definition of a related entity in the *Statement of Financial Accounting Standards No. 57*. In addition, the description must include all related parties and a level of detail that would enable the Department to easily identify them. This information may include but is not limited to the name, location, and description of the related entity, including the nature and amount of any transaction between the entity and the school, financial or otherwise, regardless of when it occurred.

## 90/10 REVENUE TEST

### Notifying ED—90/10

A school must send notice of its failure to satisfy the 90/10 Rule to the Department by U.S. mail or commercial overnight to the following address:

U.S. Department of Education,  
Federal Student Aid  
School Eligibility Service Group  
830 First Street, NE  
Washington, DC 20202-5403

General e-mail: [Caseteams@ed.gov](mailto:Caseteams@ed.gov)  
Contact phone numbers for the teams are provided at ([www.eligcert.ed.gov/](http://www.eligcert.ed.gov/)).

A proprietary school must disclose the percentage of its revenues derived from the FSA programs that the school received during the fiscal year covered by the audit as a footnote to its audited financial statements. The school must also report in the footnote the dollar amount of the numerator and denominator of its 90/10 ratio as well as the individual revenue amounts identified in section 2 of appendix C to subpart B of part 668 (see sidebar).

A school that converts from a for-profit to a nonprofit status must report its compliance with the 90/10 revenue test for the first year after its conversion. A school changing from for-profit to nonprofit must continue to file this report for the first year of its nonprofit status.

To be eligible for FSA participation, a proprietary school must derive at least 10% of its revenues for each fiscal year from sources other than the FSA programs, or be subject to sanctions. The calculation of this percentage and the funds included must be arrived at using the cash basis of accounting. A school must determine its revenue percentages using the formula described on the following pages each fiscal year.



Proprietary schools have 45 days after their most recent fiscal year has ended to report to the Department if they did not satisfy the 90/10 Rule for that period.

- ♦ If a school fails to satisfy the 90/10 rule for any fiscal year, it becomes provisionally certified for up to two fiscal years after the fiscal year it failed to satisfy the revenue requirement. (Among other factors, the provisional certification is limited by the expiration date of the school's program participation agreement.)
- ♦ If a school fails to satisfy the 90/10 rule for two consecutive fiscal years, it loses its eligibility to participate in the FSA programs for at least two fiscal years.

If the school loses eligibility, it must immediately stop awarding FSA funds and follow the closeout procedures described in *Chapter 8*.

## Counting revenues for the 90/10 rule

Section 668.28(a) of the Student Assistance General Provisions provides the following explanation of how to count revenue from

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### (3) Revenue generated from programs and activities.

The institution must consider as revenue only those funds it generates from—

- (i) Tuition, fees, and other institutional charges for students enrolled in eligible programs as defined in §668.8;
- (ii) Activities conducted by the institution that are necessary for the education and training of its students provided those activities are—

- (A) Conducted on campus or at a facility under the institution's control;
- (B) Performed under the supervision of a member of the institution's faculty; and
- (C) Required to be performed by all students in a specific educational program at the institution; and

- (iii) Funds paid by a student, or on behalf of a student by a party other than the institution, for an education or training program that is not eligible under §668.8 if the program—

- (A) Is approved or licensed by the appropriate state agency;
- (B) Is accredited by an accrediting agency recognized by the Secretary under 34 CFR part 602;
- (C) Provides an industry-recognized credential or certification, or prepares students to take an examination for an industry-recognized credential or certification issued by an independent third party;
- (D) Provides training needed for students to maintain state licensing requirements; or
- (E) Provides training needed for students to meet additional licensing requirements for specialized training for practitioners that already meet the general licensing requirements in that field.

### (4) Application of funds.

The institution must presume that any Title IV, HEA program funds it disburses, or delivers, to or on behalf of a student will be used to pay the student's tuition, fees, or institutional charges, regardless of whether the institution credits the funds to the student's account or pays the funds directly to the student, except to the extent that the student's tuition, fees, or other charges are satisfied by—

- (i) Grant funds provided by non-federal public agencies or private sources independent of the institution;
- (ii) Funds provided under a contractual arrangement with a federal, state, or local government agency for the purpose of providing job training to low-income individuals who need that training;
- (iii) Funds used by a student from a savings plan for educational expenses established by or on behalf of the student if the saving plan qualifies for special tax treatment under the Internal Revenue Code of 1986; or
- (iv) Institutional scholarships that meet the requirements in paragraph (a)(5)(iv) of this section.

### (5) Revenue generated from institutional aid.

The institution must include the following institutional aid as revenue:

- (i) For loans made to students and credited in full to the students' accounts at the institution on or after July 1, 2008, and prior to July 1, 2012, include as revenue the net present value of the loans made to students during the fiscal year, as calculated under paragraph (b) of this section, if the loans—

- (A) Are bona fide as evidenced by standalone repayment agreements between the students and the institution that are enforceable promissory notes;
- (B) Are issued at intervals related to the institution's enrollment periods;
- (C) Are subject to regular loan repayments and collections by the institution; and
- (D) Are separate from the enrollment contracts signed by the students.

[For rules on calculating the net present value of these loans, see 34 CFR 668.28(b) and Appendix C to Subpart B.]

- (ii) For loans made to students before July 1, 2008, include as revenue only the amount of payments made on those loans that the institution received during the fiscal year.
- (iii) For loans made to students on or after July 1, 2012, include as revenue only the amount of payments made on those loans that the institution received during the fiscal year.
- (iv) For scholarships provided by the institution in the form of monetary aid or tuition discount and based on the academic achievement or financial need of its students, include as revenue the amount disbursed to students during the fiscal year. The scholarships must be disbursed from an established restricted account and only to the extent that the funds in that account represent designated funds from an outside source or income earned on those funds.

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### (7) Funds excluded from revenues.

For the fiscal year, the institution does not include—

- (i) The amount of Federal Work-Study (FWS) wages paid directly to the student. However, if the institution credits the student's account with FWS funds, those funds are included as revenue;
- (ii) The amount of funds received by the institution from a state under the LEAP, SLEAP, or GAP programs;
- (iii) The amount of institutional funds used to match Title IV, HEA program funds;
- (iv) The amount of Title IV, HEA program funds refunded or returned under §668.22. If any funds from the loan disbursement used in the return calculation under §668.22 were counted as non-title IV revenue under paragraph (a) (6) of this section, the amount of Title IV, HEA program funds refunded or returned under §668.22 is considered to consist of pre-ECASLA loan amounts and loan amounts in excess of the loan limits prior to ECASLA in the same proportion to the loan disbursement; or

(v) The amount the student is charged for books, supplies, and equipment unless the institution includes that amount as tuition, fees, or other institutional charges.

## Other 90/10 guidance

### Cash basis of accounting

Except for institutional loans made to students under 34 CFR 668.28(a)(5)(i), a proprietary school must use the cash basis of accounting in calculating its revenue percentage under the 90/10 Rule. Under the cash basis of accounting, revenue is recognized when received rather than when it is earned.

### Revenue

For the purpose of calculating the qualifying percentages under the 90/10 Rule, revenue is an inflow or other enhancement of assets to an entity, or a reduction of its liabilities resulting from the delivery or production of goods or services. A school may recognize revenue only when the school receives cash, i.e., when there is an inflow of cash. As a result, in order for a school to recognize revenue under the cash basis of accounting, that revenue must represent cash received from a source outside the institution.

### Tuition waivers

Institutional grants in the form of tuition waivers do not count as revenue because no new revenue is generated. Similarly, internal transfers of cash among accounts are not considered revenue because they are not an inflow of cash to the school. Institutional scholarships are not revenues generated by the school unless they are donated by an unrelated or outside party. An exception is permitted for schools to use donations from a related party to create restricted accounts for institutional scholarships, but only the amount earned on the restricted account and used for scholarships would count as revenue in the denominator of the calculation.

Funds held as credit balances in institutional accounts cannot be counted in the 90/10 formula. However, once funds held as credit balances are used to satisfy institutional charges, they would be counted in both the numerator and the denominator of the formula.

### Revenues from loans

When a school makes a loan to a student, it does not receive cash from an outside source. Accordingly, cash revenue from institutional loans is recognized only when those loans are repaid, because that is when there is an inflow of cash from an outside source. Loan proceeds from institutional loans that were disbursed to students may not be counted in the denominator of the fraction, because these proceeds neither generate nor represent actual inflows of cash. The school may include only loan repayments it received during the appropriate fiscal year for previously disbursed institutional loans.

Loans made by a private lender that are in any manner guaranteed by the school are known as recourse loans. The proceeds from recourse loans may be included in the denominator of an institution's 90/10 calculation for the fiscal year in which the revenues were received, provided that the institution's reported revenues are also reduced by the amount of recourse loan payments made to recourse loan holders during that fiscal year. Note that recourse loan payments may be for recourse loans that were made in a prior fiscal year. Under the cash basis of accounting, the reductions to total revenues in the denominator of the 90/10 calculation are reported in the fiscal year when the payments are made.

The nonrecourse portion of a partial recourse loan may be included in a 90/10 calculation. In order to include a partial recourse loan in a 90/10 calculation, the contract must identify the percentage of the sale that is nonrecourse; only that percentage may be included. Furthermore, no after-the-fact adjustments may be provided for. Revenue generated from the sale of nonrecourse institutional loans to an unrelated third party may be counted as revenue in the denominator of the 90/10 calculation to the extent that the revenues represent actual proceeds from the sale.

The sale of institutional loan receivables is distinguishable from the sale of a school's other assets because receivables from institutional loans are produced by transactions that generate tuition revenue. Tuition revenue represents income from the major service provided by a school. That would not be true in the case of the sale of other school assets.

## AUDIT AND AUDIT REVIEW PROCESS

### *Having the audit performed*

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#### **Use of eZ-Audit required**

Schools are required to submit their compliance audits, audited financial statements, and letters confirming their status as public schools through the Department's eZ-Audit Electronic Financial Reporting System.

This requirement applies to any compliance audits or financial statements required under 34 CFR 600.20(a) or (b) to begin or continue participating in the FSA programs, any financial statements required due to a change in ownership resulting in a change in control as provided under 34 CFR 600.20(g), any compliance audits and financial statements required annually under 34 CFR 668.23, and any compliance audits and financial statements required when a school ceases to participate in the FSA programs as provided under 34 CFR 668.26(b).

The school or servicer must make its program and fiscal records, as well as individual student records, available to the auditor. (Required recordkeeping is discussed in *Chapter 7*.) Both the financial aid and business offices should be aware of the dates the auditors will be at the school, and make sure that someone is on hand to provide requested documents and answer questions during that period.

At the end of the on-site review, the auditor conducts an exit interview. At a school, this exit interview is usually conducted with the personnel from the school's financial aid and other relevant offices. The exit interview is not only an opportunity for the auditor to suggest improvements in procedures, but it also gives the school or servicer a chance to discuss the draft report and review any discrepancies cited in the report. The exit interview is a good time to resolve any disagreements before the final report is prepared.

The final report is prepared by the auditor and submitted to the school or servicer.

### *Review of FSA audit submissions*

The Department reviews the audit report for format and completeness and to ensure that it complies with the government's auditing standards.

We will use the general information to make an initial determination of whether the audits are materially complete and conducted in accordance with applicable accounting standards. Based on the financial data, we will also make a preliminary determination as to whether your school is financially responsible with respect to the financial responsibility ratios, or in the case of a change in ownership resulting in a change in control, whether the school satisfies the financial ratio requirements (discussed later in this chapter). Later, the Department will review submissions to determine whether the school must provide additional information or ED should take further action.

Based on the audit findings and the school's or servicer's written explanation, the Department will determine if any funds were spent improperly. Unless the school or servicer has properly appealed the decision, the school or servicer must repay any improperly spent funds within 45 days.

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#### **Information about eZ-audit**

Website: ([www.ezaudit.ed.gov](http://www.ezaudit.ed.gov))

E-mail contact: [fsaezaudit@ed.gov](mailto:fsaezaudit@ed.gov)

eZ-Audit Help Desk: 1-877-263-0780

## Access to records

Once the audit is complete, the school or servicer must give the Department and the OIG access to all records and documents needed to review the audit. A school that uses a third-party servicer must give the Department and the OIG access to all records and documents needed to review a third-party servicer's compliance or financial statement audit. In addition, the school's or servicer's contract with the auditor must specify that the auditor will give the Department and the OIG access to the records and documents related to the audit, including work papers. Cooperation includes providing timely and reasonable access to records (including computer records) for examination and copying and to personnel for the purpose of obtaining relevant information.

## Cooperation with audit and review process

Throughout the audit process, and for other examinations such as program reviews and state reviews, the school or servicer is required to cooperate fully with its independent auditor, the Department and its Inspector General, the Comptroller General of the United States, its accrediting agency, and the appropriate guaranty agency.

## eZ-Audit

The eZ-Audit website provides a paperless single point of submission for financial statements and audits (i.e., compliance reports). eZ-Audit provides automatic error checking as you enter the data and before submission. In addition, it gives you instant acknowledgment of receipt.

All schools that participate in the FSA programs must use eZ-Audit to submit financial statements and compliance audits (including copies of the A-133 reports that nonprofit and public institutions file with the Federal Audit Clearinghouse).

Nonprofit and public institutions are still required to submit their A-133 audits in writing to the federal clearinghouse.

## The eZ-Audit process

To access the eZ-Audit website, you must be a registered user. Each school must select an eZ-Audit institution administrator who will be responsible for managing your school's access to the eZ-Audit website. This institution administrator will receive the user name and password necessary for your school's access and will be responsible for granting access to others you name as additional users.

Each registered user must sign and retain the eZ-Audit rules of behavior. For registration instructions and to download the rules of behavior, please visit ([www.ezaudit.ed.gov](http://www.ezaudit.ed.gov)).

Once you have obtained your school ID, you will access the appropriate page on the audit website and

1. enter general information about your school's compliance audit and financial statement,
2. enter specific financial data directly from the audited financial statement, and
3. attach authentic electronic copies of the audit originals.

After you have entered the required information, you must attach a copy of the audit prepared and signed by the independent auditor. The copy must be in a non-editable, portable document format (PDF) created using Adobe Acrobat version 5.0 or higher.

## AUDITS FOR THIRD-PARTY SERVICERS

### Third-party servicers

Guidance for audits of third-party servicers is found in the January 2000 Department of Education’s “Audit Guide, Audits of Federal Student Aid Programs at Participating Institutions and Institution Servicers.”

34 CFR 668.23(a)(3) and (c)

34 CFR 668.23(d)(4)

### Failure to submit audits

The Department is aware that some third-party servicers have told schools not to report them as servicers, creating confusion about who should be reported. Also, some servicers have not filed annual compliance audits because they incorrectly determined that they don’t meet the regulatory definition of a third-party servicer or because of the omission of specific audit procedures in the OIG Audit Guide for some services or functions performed on behalf of colleges. See DCL GEN-15-01 for clarification of the third-party servicer requirements in the regulations.

**GAAP** Generally Accepted Accounting Principles

**GAAS** Generally Accepted Auditing Standards

**GAGAS** Generally Accepted Government Auditing Standards

Audit requirements also apply to third-party servicers. If a servicer contracts with several FSA schools, a single compliance audit can be performed that covers its administrative services for all schools. If a servicer contracts with only one FSA school and that school’s own audit sufficiently covers the functions performed by the servicer, the servicer does not have to submit a compliance audit. A servicer must submit its compliance audit within six months after the last day of the servicer’s fiscal year. The Department may require a servicer to provide a copy of its compliance audit report to guaranty agencies, lenders, state agencies, the Department of Veterans Affairs, or accrediting agencies.

In addition to submitting a compliance audit, a servicer that enters into a contract with a lender or guaranty agency to administer any aspect of the lender’s or guaranty agency’s programs must submit annually audited financial statements. The financial statements must be prepared on an accrual basis in accordance with Generally Accepted Accounting Principles (GAAP) and audited by an independent auditor in accordance with Generally Accepted Government Auditing Standards (GAGAS) and any other guidance contained in audit guides issued by the Department’s Office of the Inspector General.

If the Department determines that, based on audit findings and responses, a third-party servicer owes a liability for its administration of the FSA programs, the servicer must notify each school with which it has a contract of the liability. Generally, unless they submit an appeal, schools and servicers owing liabilities must repay those liabilities within 45 days of being notified by the Department.

As noted earlier, a school may never use a third-party servicer’s audit in place of its own required audit because the school is ultimately liable for its own violations as well as those incurred by its third-party servicers. (See *Chapter 3* for more information on third-party servicers.)



## DEMONSTRATING FINANCIAL RESPONSIBILITY

To participate in the FSA programs, a school must demonstrate that it is financially responsible. To provide the Department with the information necessary to evaluate a school's financial responsibility, schools are required to submit financial information to the Department every year. A school must provide this financial information in the form of an audited financial statement as part of a combined submission that also includes the school's compliance audit. For-profit schools have six months from the end of the schools' fiscal year to provide the combined submission; other schools have nine months.

What follows is an overview of the financial responsibility standards. Schools should refer to Subpart L of the Student Assistance General Provisions for complete information.

The Department determines whether a school is financially responsible based on the school's ability to provide the services described in its official publications and statements, properly administer the FSA programs in which the school participates, and meet all of its financial obligations.

The financial responsibility standards can be divided into two categories: (1) general standards, which are the basic standards used to evaluate a school's financial health, and (2) performance and affiliation standards, which are standards used to evaluate a school's past performance and to evaluate individuals affiliated with the school.

### *Financial responsibility for public schools*

A public school is financially responsible if its debts and liabilities are backed by the full faith and credit of the state or another government entity. The Department considers a public school to have that backing if the school notifies the Department that it is designated as a public school by the state, local, or municipal government entity, tribal authority, or other government entity that has the legal authority to make that designation. The school must also provide the Department with a letter from an official of the appropriate government entity confirming the school's status as a public school. A letter from a government entity may include a confirmation of public school status for more than one school under that government's purview. The letter is a one-time submission and should be submitted as a separate document.

Public schools also must meet the past performance and affiliation standards discussed later and must submit financial statements prepared in accordance with generally accepted accounting principles (GAAP) and prepared on the accrual basis.

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### **Financial responsibility**

Sec. 498(c) of the Higher Education Act  
34 CFR 668 Subpart L

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### **Tuition recovery funds**

When a state submits a tuition recovery fund for approval by the Department, the Department will consider the extent to which the recovery fund:

- provides returns to both in-state and out-of-state students;
- complies with FSA requirements for the order of return of funds to sources of assistance; and
- is replenished if any claims arise that deplete the fund.



## *Financial responsibility for proprietary or private nonprofit schools*

### **Change in ownership**

When a change in ownership occurs, the Department applies the standards in 34 CFR 668.15.

### **Deposit to operating account or separate federal bank account**

A school that maintains a separate federal bank account must deposit to that account, or transfer from its operating account to its federal account, the amount of unearned program funds, as determined under the Return of Title IV funds regulations. The date the school makes that deposit or transfer is the date used to determine whether the school returned the funds within the 45-day time frame permitted in the regulations.

Unless the Department requires a school to use a separate account, the school may use its operating account for FSA purposes. In this case the school must designate that account as its federal bank account and have an auditable system of records showing that the funds have been allocated properly and returned in a timely manner. If there is no clear audit trail, the Department can require the school to begin maintaining FSA funds in a separate bank account.

See the sections on accounting for funds and depository accounts in *Chapter 1 of Volume 4*.

34 CFR 668.163(a)

A proprietary or private nonprofit school is financially responsible if the Department determines that

- ♦ the school has a composite score of at least 1.5;
- ♦ the school has sufficient cash reserves to make the required refunds, including the return of Title IV funds (these requirements are known as the refund reserve standards);
- ♦ the school is meeting all of its financial obligations, including making required refunds, including the return of Title IV funds and making repayments to cover FSA program debts and liabilities; and
- ♦ the school is current in its debt payments.

These requirements are discussed in more detail in the next section.

Even if a school meets all of the general requirements, the Department does not consider the school to be financially responsible if—

- ♦ in the school's audited financial statement the opinion expressed by the auditor was adverse, qualified, or disclaimed, or the auditor expressed doubt about the continued existence of the school as a going concern (unless the Department determines that a qualified or disclaimed opinion does not have a significant bearing on the school's financial condition), or
- ♦ the school violated one of the past performance requirements discussed later in this chapter.

## STANDARDS FOR FINANCIAL RESPONSIBILITY

### Composite score

The composite score standard combines different measures of fundamental elements of financial health to yield a single measure of a school's overall financial health. This method allows financial strength in one area to make up for financial weakness in another area and gives an equitable measure of the financial health of schools of different sizes.

The composite score methodology takes into account the differences between proprietary schools and private nonprofit schools. The variance takes into account the accounting differences between these sectors of postsecondary schools. However, the basic steps used to arrive at the composite score are the same. These steps are described later in this section.

### Refund reserve standards

One of the standards that a school must satisfy to be considered financially responsible is that it must have sufficient cash reserves to return FSA funds when a student withdraws. A school is considered to have sufficient cash reserves if it

- ♦ is located in a state that has an ED-approved tuition recovery fund and the school contributes to that fund, or
- ♦ for its two most recently completed fiscal years, the school made all required returns in a timely manner (see *Volume 5, Chapter 2* for more information on returns, including timely payment).

### Returning funds in a timely manner

Unearned funds must be returned no later than 45 days after the date of the school's determination that the student withdrew. ED considers the school to have returned funds, depending upon the method it uses to return them. Specifically, the regulations provide that a school has returned funds when it has

- ♦ deposited or transferred the funds into the bank account it maintains for federal funds (see sidebar) no later than 45 days after the date it determines that the student withdrew,
- ♦ initiated an electronic funds transfer (EFT) no later than 45 days after the date it determines that the student withdrew, or
- ♦ issued a check no later than 45 days (as supported by the school's records) after the date it determines that the student withdrew.

If a check is used to return unearned funds, the Department requires that the check be endorsed by ED no later than 60 days after the school's determination that a student withdrew to be considered a timely return.

### Financial responsibility

Treatment of long-term debt  
DCL GEN 03-08, July 2003  
34 CFR 668, Subpart L, Appendices A and B  
Ratios  
34 CFR 668.172  
Refund reserve standards  
34 CFR 668.173  
Returning funds in a timely manner  
34 CFR 668.22

### Additional information on composite scores

For complete information on the calculation of the composite score, schools should refer to Appendices A and B of Subpart L in the General Provisions regulations.

The Department has issued guidance on the treatment of long-term and other debt in calculating these ratios. The most recent can be found in DCL GEN-03-08.

### Return of Title IV funds

The requirements for return of Title IV funds for students who withdraw from the educational program are described in *Volume 5*.

### Making new awards with returned funds

After a school has returned unearned funds to its federal account, provided those funds were originally received from the Department or from an FFEL lender under a process that allows the school to reuse the unearned funds, the school can use the funds to make disbursements to other eligible students.

### *Compliance thresholds for timely return of funds*

The Department provides for a small margin of error in determining that a school has paid all required refunds and returns on time. The Department considers a school to have paid returns in a timely manner if—

- ♦ there is less than a 5% error rate in a sample of returns (composed of students for whom the school was required to return unearned funds) examined in a compliance audit, an audit conducted by the Office of the Inspector General (OIG), or a program review conducted by the Department or guaranty agency, or
- ♦ there are no more than two late returns in the sample (regardless of the number or percentage of late returns in the sample).

In addition, if the reviewer or auditor finds a material weakness or reportable condition in the school's report on internal controls relating to the return of unearned Title IV aid, the Department considers the school to have not paid returns in a timely manner.

### *Letter of credit required when funds are not returned in a timely manner*

#### **Address for Letters of Credit**

Letters of credit are submitted to:

Director  
Performance Improvement & Procedures  
U.S. Department of Education  
Federal Student Aid  
830 First Street, NE  
UCP-3, MS 5435  
Washington, DC 20002-8019

Public schools and schools covered by a state tuition recovery fund that has been approved by the Department are not subject to the letter of credit requirements. If any other school exceeds the compliance thresholds in either of its two most recently completed fiscal years, the school must submit an irrevocable letter of credit acceptable and payable to the Department. The letter of credit must be equal to 25% of the returns the school made or should have made during its most recently completed fiscal year.

A school that is required to submit a letter of credit must do so no later than 30 days after the earlier of the date that:

- ♦ the school is required to submit its compliance audit;
- ♦ the OIG issues a final audit report;
- ♦ the designated department official issues a final program review determination;
- ♦ the Department issues a preliminary program review report or draft audit report, or a guaranty agency issues a preliminary report showing that the school did not return unearned funds for more than 10% of the sampled students; or
- ♦ ED sends a written notice to the school requesting the letter of credit that explains why the school has failed to return unearned funds in a timely manner.

If the finding in the preliminary report is that the school did not return unearned funds in a timely manner for 10% or fewer of the sampled students, a school would generally be required to submit the letter of credit only if the final report shows that the school did not return unearned funds in a timely manner for 5% or more of all the students in the sample. If the final report indicates that a letter of credit is required, the school would have to submit it no later than 30 days after the final report is issued.

### *Exceptions to the letter of credit requirement*

A school is not required to submit a letter of credit of less than \$5,000. However, to meet the reserve requirement, such a school would need to demonstrate that it has available at all times cash reserves of at least \$5,000 to make required returns.

In addition, a school may delay submitting a letter of credit while it asks for reconsideration of a finding that it failed to return unearned FSA funds in a timely manner. A school may request that the Department reconsider its finding if the school submits documents showing that

- ♦ the unearned FSA funds were not returned in a timely manner solely because of exceptional circumstances beyond the school's control and that the school would not have exceeded the applicable threshold had it not been for the exceptional circumstances; or
- ♦ it did not fail to make timely returns.

A school that submits an appeal, together with all required supporting documents, by the date the letter of credit would be due is not required to submit a letter of credit unless the Department notifies the school that its request has been denied.

### *Current in debt payments*

A school is not current in its debt payments if

- ♦ it is in violation of any existing loan agreement at its fiscal year end, as disclosed in a note to its audited financial statements or audit opinion, or
- ♦ it fails to make a payment in accordance with existing debt obligations for more than 120 days, and at least one creditor has filed suit to recover funds under those obligations.

## Calculating a composite score

The first step in calculating a school's composite score is to determine the school's primary reserve, equity, and net income ratios by using information from the school's audited financial statement. These ratios take into account the total financial resources of the school. The Primary Reserve Ratio represents a measure of a school's viability and liquidity. The Equity Ratio represents a measure of a school's capital resources and its ability to borrow. The Net Income Ratio represents a measure of a school's profitability.

Upon review, some items from a school's audited financial statement may be excluded from the calculation of the ratios. For example, the Department may exclude the effects of questionable accounting treatments, such as excessive capitalization of marketing costs, from the ratio calculations. (See the regulatory exclusions below.)

All long-term debt obtained for the school's purposes may be included for purposes of the Primary Reserve Ratio calculation. However, it is important to note that the overall level of debt obtained for long-term purposes that can be included in the numerator of the Primary Reserve Ratio is limited under the regulations. It cannot exceed the amount of the school's net property, plant, and equipment.

A strength factor score is then calculated for each ratio using equations established by the Department. A strength factor score reflects a school's relative strength or weakness in a fundamental element

of financial health, as measured by the ratios. Specifically, the strength factor scores reflect the extent to which a school has the financial resources to: 1) replace existing technology with newer technology; 2) replace physical capital that wears out over time; 3) recruit, retain, and retrain faculty and staff (human capital); and 4) develop new programs.

A weighting percentage is applied to each strength factor score to obtain a weighted score for each ratio. The weighting percentages reflect the relative importance that each fundamental element has for a school in a particular sector (proprietary or private nonprofit).

The sum of the weighted scores equals the school's composite score. Because the weighted scores reflect the strengths and weaknesses represented by the ratios and take into account the importance of those strengths and weaknesses, a strength in the weighted score of one ratio may compensate for a weakness in the weighted score of another ratio.

Once a composite score is calculated, it is measured along a common scale from negative 1.0 to positive 3.0 as indicated in the diagram on page 75. This scale reflects the probability a school will be able to continue operations and meet its obligations to students and the Department.

### Exclusions

Excluded items. In calculating an institution's ratios, the Secretary—

- (1) Generally excludes extraordinary gains or losses, income or losses from discontinued operations, prior period adjustments, the cumulative effect of changes in accounting principles, and the effect of changes in accounting estimates;
- (2) May include or exclude the effects of questionable accounting treatments, such as excessive capitalization of marketing costs;
- (3) Excludes all unsecured or uncollateralized related-party receivables;
- (4) Excludes all intangible assets defined as intangible in accordance with generally accepted accounting principles; and

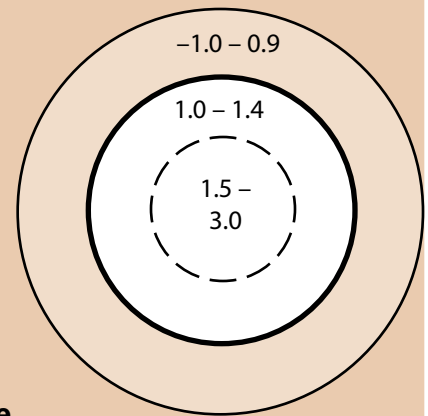
- (5) Excludes from the ratio calculations federal funds provided to an institution by the Secretary under program authorized by the HEA only if—

- (i) In the notes to the institution's audited financial statement, or as a separate attestation, the auditor discloses by name and Catalog of Federal Domestic Assistance (CFDA) number the amount of HEA program funds reported as expenses in the Statement of Activities for the fiscal year covered by that audit or attestation; and
- (ii) The institution's composite score, as determined by the Secretary, is less than 1.5 before the reported expenses arising from those HEA funds are excluded from the ratio calculations.

34 CFR 172(c)

### Composite score scale

- 1.5 to 3.0** Financially responsible without further oversight.
- 1.0 to 1.4** In the “Zone.” The school is considered financially responsible, but additional oversight is required.
- 1.0 to 0.9** Not financially responsible. The school must submit a letter of credit of at least 50% of its FSA funding. The school may be permitted to participate under provisional certification with a smaller letter of credit—with a minimum of 10% of its FSA funding and additional oversight.



### Example: Calculation of a composite score for a proprietary institution\*

#### Calculation of Ratios

$$\text{Primary Reserve Ratio} = \frac{\text{Adjusted equity}}{\text{Total expenses}} = \frac{\$760,000}{\$9,500,000} = 0.0800$$

$$\text{Equity Ratio} = \frac{\text{Modified equity}}{\text{Modified Assets}} = \frac{\$810,000}{\$2,440,000} = 0.3320$$

$$\text{Net Income Ratio} = \frac{\text{Income before taxes}}{\text{Total revenues}} = \frac{\$510,000}{\$10,010,000} = 0.0509$$

#### Calculation of Strength Factor Score

$$\text{Primary Reserve Strength Factor Score} = 20 \times \text{Primary Reserve Ratio} \\ 20 \times 0.0800 = 1.6000$$

$$\text{Equity Strength Factor Score} = 6 \times \text{Equity Ratio} \\ 6 \times 0.3320 = 1.9920$$

$$\text{Net Income Strength Factor Score} = 1 + (33.3 \times \text{Net Income Ratio}) \\ 1 + (33.3 \times 0.0509) = 2.6950$$

#### Calculation of Weighted Score

$$\text{Primary Reserve Weighted Score} = 30\% \times \text{Primary Reserve Strength Factor Score} \\ 0.30 \times 1.6000 = 0.4800$$

$$\text{Equity Weighted Score} = 40\% \times \text{Equity Strength Factor Score} \\ 0.40 \times 1.9920 = 0.7968$$

$$\text{Net Income Weighted Score} = 30\% \times \text{Net Income Strength Factor Score} \\ 0.30 \times 2.6950 = 0.8094$$

#### Composite Score

$$\text{Sum of All Weighted Scores} \quad 0.4800 + 0.7968 + 0.8094 = 2.0862 \quad \text{rounded to 2.1}$$

\* The definition of terms used in the ratios and the applicable strength factor algorithms and weighting percentages are found in the Student Assistance General Provisions (regulations) (34 CFR 668) Subpart L, Appendix A for proprietary schools and Appendix B for private nonprofit schools.

## ALTERNATIVES TO THE GENERAL FINANCIAL STANDARDS

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### Alternative standards and requirements

34 CFR 668.175

If a school does not meet the general standards for financial responsibility, the Department may still consider the school to be financially responsible or may allow the school to participate under provisional certification if the school qualifies for an alternative standard.

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### Provisional certification

34 CFR 668.13

If the Department determines that a school that does not meet one or more of the general standards and does not qualify for an alternative, the Department may initiate a limitation, suspension, or termination action against the school (see *Chapter 8* for more information on corrective actions and sanctions).

### *Letter of credit alternative for new schools*

A new school (a school that seeks to participate in the FSA programs for the first time) that does not meet the composite score standard (i.e., has a composite score of less than 1.5) but meets all other standards may demonstrate financial responsibility by submitting an irrevocable letter of credit to the Department. The letter of credit must be acceptable and payable to the Department and equal to at least 50% of the FSA program funds that the Department determines that the school will receive during its initial year of participation.

### *Letter of credit alternative for participating schools*

A participating proprietary or private nonprofit school that fails to meet one or more of the general standards or is not financially responsible because it has an adverse audit opinion may demonstrate financial responsibility by submitting an irrevocable letter of credit to the Department. The letter must be acceptable and payable to the Department and equal to at least 50% of the FSA program funds the school received during its most recently completed fiscal year. The school is then considered to be financially responsible.



## Zone alternative

A participating school that fails to meet the composite score standard (i.e., has a composite score of less than 1.5) but meets all other standards may demonstrate financial responsibility for up to three consecutive fiscal years if the Department determines that the school's composite score is equal to 1.0 to 1.4 for each of those years and the school meets specific monitoring requirements.

This alternative gives a school the opportunity to improve its financial condition over time without requiring the school to post a letter of credit or participate under provisional certification. Under the zone alternative, a school's operations, including its administration of the FSA programs, are monitored more closely. If a school does not score at least 1.0 in one of the three subsequent fiscal years or does not improve its financial condition to attain a composite score of at least 1.5 by the end of the three-year period, the school must satisfy another alternative standard to continue participating. In addition, if a school fails to comply with the information reporting or payment method requirements, the Department may determine that the school no longer qualifies under this alternative.

Under the zone alternative, a school

- ♦ must request and receive funds under the cash monitoring or reimbursement payment methods, as specified by the Department (see *Volume 4, Chapter 2*);
- ♦ must provide timely information regarding certain oversight and financial events (see the sidebar);
- ♦ may be required to submit its financial statement and compliance audit earlier than normally required (see the discussion of audit submission deadlines earlier in this chapter); and
- ♦ may be required to provide information about its current operations and future plans.

The school must also require its auditor to express an opinion, as part of the school's compliance audit, on the school's compliance with the requirements of the zone alternative, including the school's administration of the payment method under which the school received and disbursed FSA program funds.

### Information to be provided under the zone alternative

The school must provide timely information regarding any of the following oversight and financial events:

- Any adverse action, including a probation or similar action, taken against the school by its accrediting agency;
- Any event that causes the school, or related entity as defined in the *Statement of Financial Accounting Standards No. 57*, to realize any liability that was noted as a contingent liability in the institution's or related entity's most recent audited financial statement;
- Any violation by the school of any loan agreement;
- Any failure of the school to make a payment in accordance with its debt obligations that results in a creditor filing suit to recover funds under those obligations;
- Any withdrawal of owner's equity from the school by any means, including declaring a dividend; or
- Any extraordinary losses, as defined according to Accounting Principles Board (APB) Opinion No. 30.

The school may also be required to:

- submit its financial statement and compliance audits earlier than the time specified under 34 CFR 668.23(a)(4); and
- provide information about its current operations and future plans.

34 CFR 668.175(d)(2)

### *Provisional certification for schools not meeting standards*

The Department may permit a participating proprietary or private nonprofit school to participate under provisional certification for up to three years if the school is not financially responsible because it does not satisfy one or more of the general standards, has an unacceptable audit opinion, or has a past performance problem that has been resolved.

If the Department permits a school to participate under provisional certification, it will require the school

- ♦ to submit a letter of credit, payable and acceptable to the Department, for a percentage (10%–100%) of the FSA program funds received by the school during its most recent fiscal year; and
- ♦ to demonstrate that it has met all of its financial obligations and was current on debt payments for its two most recent fiscal years.

Moreover, the school must comply with the requirement under the zone alternative that it provide timely information regarding certain oversight and financial events. Finally, a school that is required to post a letter of credit will be placed on heightened cash monitoring or reimbursement.

If a school is still not financially responsible at the end of a period of provisional certification, the Department may again permit provisional certification. However, the Department may require the school or persons or entities that exercise substantial control over the school to submit financial guarantees to the Department to satisfy any potential liabilities arising from the school's FSA program participation. The same persons may be required to agree to be jointly and severally liable for any FSA program liabilities.

The Department is not required to offer provisional certification to a school. It is an alternative that the Department may choose to offer in exceptional circumstances.

### *Provisional certification for schools where persons or entities owe liabilities*

If a school is not financially responsible because the persons or entities that exercise substantial control over the school owe an FSA program liability, the Department may permit the school to participate under provisional certification if:

- ♦ the persons or entities that owe the liability repay or enter into an agreement with the Department to repay the liability (or the school assumes the liability and repays or enters into an agreement to repay the liability);
- ♦ the school meets all the general standards of financial responsibility and demonstrates that it has met all of its financial obligations and was current on its debt payments for its two most recent fiscal years; and
- ♦ the school submits to the Department a letter of credit, payable and acceptable to the Department, for an amount determined by the Department (at least 10% of the FSA program funds received by the school during its most recent fiscal year).

The school also must comply with the requirements under the zone alternative.

In addition, the Department may require the school or persons or entities that exercise substantial control over the school to submit financial guarantees to the Department to satisfy any potential liabilities arising from the school's FSA program participation. The same persons may be required to agree to be jointly and severally liable for any FSA program liabilities.

## PAST PERFORMANCE AND AFFILIATION STANDARDS

### Past performance

34 CFR 668.174

In addition to meeting the numeric standards of financial responsibility and fulfilling all its financial obligations, a school must demonstrate that it properly administers the FSA programs in which it participates. Past actions of the school or individuals affiliated with the school may reveal mismanagement of FSA program funds, thereby demonstrating that a school is not financially responsible. Therefore, in evaluating the way a school administers the FSA programs, the Department considers the past performance of both the school and individuals affiliated with the school.

### *Past performance of a school*

A school is not financially responsible if it

- ♦ in the last five years, has been subject to a limitation, suspension, or termination action or has entered into an agreement to resolve a limitation, suspension, or termination action initiated by the Department or a guaranty agency;
- ♦ in either of its two most recent FSA program reviews or audits, has had findings for the current fiscal year or two preceding fiscal years that required repayment of more than 5% of the FSA program funds received by the school;
- ♦ has been cited during the last five years for failing to submit audits as required; or
- ♦ has failed to satisfactorily resolve any compliance issues identified in program reviews or audit reports, upheld in a final decision of the Department.

### *Past performance of persons affiliated with a school*

A school is not financially responsible if any person who exercises substantial control over the school (or any members of the person's family alone or together) owes a liability for an FSA program violation or has ever exercised substantial control over another school (or a third-party servicer) that owes a liability for an FSA program violation, unless that person, family member, school, or servicer demonstrates that the liability is being repaid in accordance with an agreement with the Department.

### Notifying the Department of change of control

A school must report any changes of control under which a person acquires the ability to affect substantially the actions of the school. Such changes in control trigger a review to determine if the school is financially responsible (see *Chapter 5*).

The Department may consider a school that does not meet this requirement to be financially responsible if the school

- ♦ notifies the Department that the individual repaid to the Department an acceptable portion of the liability, in accordance with the regulations;
- ♦ notifies the Department that the liability is currently being repaid in accordance with a written agreement with the Department; or
- ♦ demonstrates to the satisfaction of the Department: (1) why the person who exercises substantial control should nevertheless be considered to lack that control, or (2) why the person who exercises substantial control and each member of that person's family does not or did not exercise substantial control over the school or servicer that owes the liability.

## LIMITATIONS

An otherwise eligible institution becomes an ineligible institution if the school exceeds

- ♦ the 50% limit on students without a high school diploma or equivalent,
- ♦ the incarcerated student limitation (25%), or
- ♦ the correspondence course limitation (50%) or the correspondence student limitation (50%).

A school must calculate these percentages to demonstrate compliance with a requirement or to demonstrate eligibility for a limitation waiver. For each of the tests, the calculation performed by the school must be attested to by the independent auditor who prepares the school's audited financial statement or its FSA compliance audit. If a school's initial or previous calculation was in error, the auditor's report must be part of the audit workpapers and must include a recalculation. The auditor's attestation report must indicate whether the school's determinations (including any relevant waiver or exception) are accurate.

For each of the limitation requirements, the school must notify the Department (via Section G of the E-App) of the school's failure to meet a requirement, its falling within a prohibited limitation, or its ineligibility for a continued waiver, as applicable. The school's notification must occur by July 31 following the end of an award year. A school that fails to meet any of these requirements loses its eligibility to participate in any FSA program as of the last day of the most recent award year for which the school failed to meet the requirement.

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### Conditions of institutional ineligibility

34 CFR 600.7

In addition to the limitations discussed in this chapter, a school is not eligible if it (or its owner) files for bankruptcy or if the school, its owner, or its CEO is responsible for a crime involving FSA program funds. See chapters 1 and 3.

A school that becomes ineligible because of one of these factors must immediately stop awarding FSA funds and must follow the requirements for a school that has lost its FSA participation (see *Chapter 8*).

If a school loses its eligibility because it failed to meet one or more of the limitation requirements, the school cannot regain eligibility until it can demonstrate that it was in compliance with all of the limitation requirements for the most recently completed award year. Once this has occurred, the school may apply to regain its eligibility. In addition, it must also show how its administrative practices and policies have been changed to ensure that it will not fall within prohibited limits in the future.

### ***Limitation on students admitted without a high school diploma or equivalent***

A school that does not provide a 4-year bachelor's degree program or a 2-year associate degree program is ineligible if, for its latest complete award year, more than 50% of its regular enrolled students had neither a high school diploma nor its equivalent.

If a public or private nonprofit institution exceeds the 50% limit because it serves significant numbers of these students through contracts with federal, state, or local government agencies, the Department may waive the limitation.

The waiver will only be granted if no more than 40% of school's regular students (those students not receiving job training through contracts with federal, state, or local government agencies) do not have a high school diploma or its equivalent. If granted, the waiver may be extended in each year the public or private nonprofit school continues to meet the requirements. The public or private nonprofit school's calculation must be attested to by an independent auditor each year an audit is conducted.

### ***Incarcerated student limitation and waiver***

A school is ineligible if, in its latest complete award year, more than 25% of its regular students are incarcerated. For information on the eligibility of incarcerated students for FSA, see *Volume 1, Chapter 1*.

A public or private nonprofit school can ask the Department to waive this limitation. If granted, the waiver is effective as long as the school continues to meet the waiver requirements each award year. For a school offering only 2-year or 4-year programs that lead to associate or bachelor's degrees, the waiver applies to all programs at the school. But if the school offers other types of programs, the waiver would apply to any of the school's 2-year associate degree programs or 4-year bachelor's degree programs and also to any other programs in which the incarcerated regular students enrolled have a 50% or greater completion rate. The calculation of this completion rate is specified in 34 CFR 600.7(e)(2) of the institutional eligibility regulations and must be attested to by an independent auditor.

A public or private nonprofit school may request the waiver using the E-App ([www.eligcert.ed.gov](http://www.eligcert.ed.gov)) by answering the questions in Section G and explaining in question 69.

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#### **Incarcerated student definition**

A student who is serving a criminal sentence in a federal, state, or local penitentiary, prison, jail, reformatory, work farm, or other similar correctional institution (this does not include detention in a halfway house, home detention, or weekend-only sentences).

## Correspondence course and correspondence student limitation

In general, a school is ineligible if for the latest complete award year

- ♦ more than 50% of the school's courses were correspondence courses (correspondence course limitation) or
- ♦ 50% or more of the school's regular students were enrolled in correspondence courses (correspondence student limitation). This limitation may be waived for a school that offers a 2-year associate degree or 4-year baccalaureate degree program if the school demonstrates to the Department that in that award year, the students enrolled in its correspondence courses receive no more than 5% of the total FSA program funds received by all of the school's students.

Note that the correspondence course and student limitations do not apply to a school that exclusively or mainly provides vocational adult education or job training as defined under Sec. 3(3)(C) of the Carl D. Perkins Career and Technical Education Act of 2006.

Also note that the 50% limits apply to the school, not to its individual programs. An educational program composed entirely of correspondence courses could still be an eligible program if no more than 50% of the school's courses were offered through correspondence and the program met other eligibility requirements.

The school's correspondence course calculation and correspondence student calculation must be attested to by an independent auditor.

For additional information on correspondence study in the context of program eligibility, see *Chapter 2*.

## Correspondence student eligibility

For information about a student's eligibility for FSA funds while enrolled in a correspondence course and cost of attendance information for correspondence courses, see *Volume 1, Chapter 1* and *Volume 3, Chapter 2*.

## Limitations on incarcerated students and correspondence study

Incarcerated students  
34 CFR 600.7(a)(1)(iii) and 600.7(c)  
Correspondence study  
Sec. 102(a)(3)(A) and (B) of the HEA  
34 CFR 600.7(a)(1)(i) and (ii) and 600.7(b)(2)(i) and (ii)

## Notifying ED when limit is exceeded

34 CFR 600.7(h)  
If there is a change to any of a school's answers to the Yes/No questions in Section G of a submitted Electronic Application (E-App) (which deal with enrollment thresholds in these areas), the school must notify the Department via the E-App (see *Chapter 5*). The Department will advise the school of its options, including whether it might be eligible for a waiver. (Waivers are available for the limitations for correspondence students, incarcerated students, and students without a high school diploma or equivalent.)

## A school is the sum only of its eligible programs

Some postsecondary institutions offer programs that are eligible for FSA as well as programs that are not FSA-eligible. For FSA program purposes, we consider an eligible institution is the sum of its eligible programs.

To minimize the effect on its institutional eligibility of offering programs solely by correspondence that do not lead to a degree, a school might choose to identify those programs as not part of its FSA-eligible programs. A program (and students enrolled therein) that was so identified would not be considered part of the school in these two formulas.

**Carl D. Perkins Career and Technical Education Act of 2006**  
20 U.S.C. 2301



## Calculating the Percentages

### Calculating the percentage of Correspondence courses

- If a school offers a course both by correspondence and residential training, the course counts twice, as a correspondence course and as a residential course. Thus, it would count as one in the numerator and as two in the denominator.
- Regardless of how many sections of a course or program are offered during the award year (as a residential or as a correspondence course), the course is counted only once under each type.
- A program not offered in courses or modules counts as one correspondence course.

Using the latest complete award year, the formula for determining the percentage of correspondence courses is as follows:

$$\frac{\text{number of school's correspondence courses}}{\text{total number of school's courses}} = \% \text{ of correspondence courses}$$

### Calculating the percentage of correspondence students

- All regular students enrolled in an institution's Title IV-eligible programs must be counted. (A regular student is "a person enrolled for the purpose of obtaining a degree, certificate, or other recognized educational credential offered by the school.")
- A school must use a straight head count of enrolled students, including full-time and part-time students and students who don't receive aid as well as FSA recipients.
- If a student withdrew from the school and received a full refund, the student is not counted.

Using the latest complete award year, the formula for determining the percentage of enrolled students is as follows:

$$\frac{\text{number of regular students enrolled in the school's correspondence courses}}{\text{number of regular students enrolled in all of the school's courses}} = \% \text{ of correspondence students}$$

## COHORT DEFAULT RATES

A school's eligibility for the FSA programs can be affected by a high cohort default rate (CDR). The Department calculates a school's CDR based on information from guaranty agencies and federal loan servicers.

The Department sends draft default rates to participating schools in February to allow each school an opportunity to review and correct the data that will be used to calculate its official cohort default rates. In September of each year, the Department issues the official cohort default rates. These rates are electronically delivered to schools and posted on the NSLDS Professional Access website. A school must be enrolled in the eCDR process for electronic delivery of the rates (see sidebar note for instructions and appeal procedures).

### Time frames for cohort default rates

A school's annual CDR is based on a "cohort" of students who received FFEL or Direct Loans at the school and entered repayment in a single fiscal year—the federal fiscal year, October 1–September 30.

For instance, a school's FY2013 CDR is based on the cohort of students who received FFEL or Direct Loans at the school and entered repayment on those loans between October 1, 2012, and September 30, 2013. This number becomes the denominator (the lower part of the fraction) in the CDR calculation.

$$\frac{\text{X}}{\text{Total borrowers who entered repayment during FY2013}}$$

The Department tracks this group of students during the fiscal year in which they enter repayment and through the end of the second following fiscal year. The number of students who default on their loans (or meet other related conditions) during those three fiscal years becomes the numerator (top part of the fraction) in the CDR calculation.

$$\frac{\text{Total borrowers who entered repayment in FY2013 and defaulted in FY2013, 2014, and 2015}}{\text{Total borrowers who entered repayment during FY2013}}$$

Because it takes three years to track the outcomes, the initial FY2013 CDR for a school is not released until three years later, at the beginning of 2016. This is one of the reasons that schools should closely monitor student borrowing and implement effective default prevention procedures as soon as possible. The steps taken to help students this year may reduce the number of defaults in the CDR three years from now.

The terminology, criteria, calculations, and exceptions for the rates are described in more detail in the *Cohort Default Rate Guide*.

### Default rates

HEA Sec. 435(m)  
20 U.S.C. 1082, 1085, 1094, 1099c  
34 CFR Part 668 Subpart N

### High default rates

34 CFR 668.206

### DCL GEN-14-03 Cohort Default Rate Guide

For information on procedures for challenges, adjustments, and appeals, refer to Part 4 of the *Cohort Default Rate Guide*. ([www.ifap.ed.gov/DefaultManagement/finalcdrg.html](http://www.ifap.ed.gov/DefaultManagement/finalcdrg.html))

### Default rates on the Web

Searchable default rates for all schools participating in the FSA programs are posted on the Web at ([www.ed.gov/FSA/defaultmanagement](http://www.ed.gov/FSA/defaultmanagement)).

The Department also publishes *Budget Lifetime Default Rates* and *Cumulative Lifetime Default Rates* for the FFEL and Direct Loan Programs. These rates, which include additional defaults in years after the close of the CDR "default window," do not affect a school's eligibility.

### The eCDR process

ED sends the draft and official cohort default rates electronically to all schools participating in the FSA Programs. You must enroll in the eCDR process to receive your rates.

If your school is not enrolled, go to (<https://fsaweb.enroll.ed.gov/>). On that page choose "Enroll" and then select the radio button for "Modify Existing Services for a Destination Point."

## Consequences of high cohort default rates

### High default rates

34 CFR 668.206  
DCL GEN-14-03

### Default rates and administrative capability

34 CFR 668.16(m)

#### Contacting the default office

The Operations Performance Division in Federal Student Aid responds to questions about FFEL/DL cohort default rates, and reviews FFEL/DL cohort default rate challenges, adjustments, and appeals. It also provides technical assistance and outreach to schools to assist them in lowering their default rates.

Web: ([www.ifap.ed.gov/DefaultManagement](http://www.ifap.ed.gov/DefaultManagement))  
Hotline: 202-377-4259  
FAX: 202-275-0913  
Email: ([fsa.schools.default.management@ed.gov](mailto:fsa.schools.default.management@ed.gov))

### Default prevention and management plan and sample

34 CFR 668.217

See ([www.ifap.ed.gov/DefaultPreventionResourceInfo/index.html](http://www.ifap.ed.gov/DefaultPreventionResourceInfo/index.html)) for more information.

See the “Sample Default Prevention and Management Plan” that was issued as an attachment to GEN-05-14.

Schools face sanctions under the following conditions:

- ♦ For a cohort default rate of greater than 40 percent for any year, schools lose eligibility to participate in the Direct Loan Program.
- ♦ For a default rate of 30 percent or more for any year, they must create a default prevention taskforce that will develop and implement a plan to address the high default rate. That plan must be submitted to the Department for review.
- ♦ For a default rate of 30 percent or more for a second consecutive year, they must submit to the Department a revised default prevention plan and may be placed on provisional certification.
- ♦ For a cohort default rate of 30 percent or more for three consecutive years, schools lose eligibility to participate in both the Direct Loan Program and the Federal Pell Grant Program.

Moreover, a school is not considered to be administratively capable when

- ♦ the CDR for Federal Stafford/SLS loans or Direct Subsidized/Unsubsidized Loans made to students for attendance at the school equals or exceeds 30% for two of the three most recent fiscal years or
- ♦ the CDR for Perkins loans made to students for attendance at the school exceeds 15%. See *Volume 6* for other rules and associated penalties related specifically to high Perkins default rates.

When a high default rate demonstrates a lack of administrative capability, a school may become ineligible to participate in the Direct Loan, Pell Grant, or Perkins programs, or the Department may choose to provisionally certify such a school. For detailed information on default rates, including challenges and appeals, refer to the *Cohort Default Rate Guide* on the IFAP website.

### *Default prevention and management plan*

As mentioned, if a school's cohort default rate is equal to or greater than 30%, it must establish a default prevention task force that prepares a plan that

- ♦ identifies the factors causing the default rate to exceed the threshold,
- ♦ establishes measurable objectives and the steps the school will take to improve the default rate, and
- ♦ specifies the actions the school will take to improve student loan repayment, including counseling students on repayment options.

A school must submit its default prevention plan to its school participation division for review. If the cohort default rate is equal to or greater than 30% for two consecutive fiscal years, the default prevention plan must be revised and submitted again for review.

### *Default prevention and management plan for new schools*

New schools are required to implement a default prevention and management plan prior to certification. In addition, a school that undergoes a change in ownership that results in a change in control or a school that changes its status as a main campus, branch campus, or additional location must implement a default management plan.

A school applying to participate is exempt from submitting a default plan if the school, including its main campus and any branch campus, does not have a cohort default rate greater than 10% and the new owner of the school does not own and has not owned any other school that had a cohort default rate greater than 10% during the owner's tenure.

## DEBT-TO-EARNINGS (D/E) RATES FOR GE PROGRAMS

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### Gainful employment programs

34 CFR 668 Subpart Q  
DCL GEN-15-12

As with cohort default rates and financial standard composite scores, the D/E rates for schools' gainful employment (GE) programs are a measure that bears on eligibility, in this case the eligibility of specific programs.

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### GE publications

The webpage at (<http://ifap.ed.gov/GainfulEmploymentInfo/indexV2.html>) is a compilation of GE materials.

Schools must report for an award year information on each student who received Title IV aid for enrollment in a GE program. The information includes private and institutional loans and other financing for the student's enrollment, as well as the amount assessed for tuition, fees, books, supplies, and equipment. Refer to the NSLDS Gainful Employment User Guide for the specific data to report for each student each award year. The information reported will be used by the Department for calculating D/E rates and creating other information that schools must disclose: e.g., completion, median earnings and loan debt.

Schools must report GE data annually by October 1 following the end of the award year (e.g., October 1, 2016, for the 2015–2016 award year), unless the Secretary establishes a different date.

In cases where a student received Title IV aid for more than one GE program, he is reported for each program. If he was enrolled in a program for more than one award year, he is reported separately for each year, beginning with the year he first received Title IV aid for the program and for each following year even if he does not receive Title IV aid in that year. If he withdrew from a GE program and then re-enrolled in it, he is reported separately for each enrollment even if they were in the same award year.

## Calculation of D/E rates

The Department calculates D/E rates for each GE program for each award year using the debt and earnings of students who completed the program during a specified cohort period. That period will be two years if 30 or more students completed the program during that period or four years if fewer than 30 students completed the program in two years. If fewer than 30 students finished in the four-year cohort, D/E rates will not be calculated for that GE program. Students who qualify for exclusion are not included in that number.

The two-year and four-year cohorts comprise students who completed the program during the third and fourth years and the third through sixth years respectively prior to the award year the D/E rates are being calculated for. For example, to determine the D/E rates for the 2016–2017 award year, the two-year cohort period will be award years 2012–2013 and 2013–2014, and the four-year cohort period will be 2010–2011 through 2013–2014.

We calculate separately an annual earnings rate and a discretionary income rate. The annual earnings rate equals

$$\frac{\text{Annual loan payment}}{\text{The higher of the mean or median annual earnings}}$$

The discretionary income rate equals

$$\frac{\text{Annual loan payment}}{\text{The higher of the mean or median annual earnings} - (1.5 \times \text{HHS poverty guideline})}$$

The annual loan payment is determined by amortizing the median loan debt of students who completed the GE program during the cohort period. Median loan debt includes not only the amount of Title IV loans that students borrowed for enrollment in the GE program, but also private education loans and the total amount outstanding, as of the date they completed the program, on any other credit (including unpaid charges) extended by or on behalf of the institution that the students are obligated to repay. For the purpose of this calculation, students' loan debt is capped at the lesser of the debt they incurred for enrollment in the program or the total amount of their tuition, fees, books, supplies, and equipment.

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### Calculating D/E rates

34 CFR 668.404

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### Challenges to draft rates

34 CFR 668.405(f)

The median loan debt is amortized over a repayment period of

- ♦ 10 years for a program leading to an undergraduate certificate, a post-baccalaureate certificate, an associate degree, or a graduate certificate;
- ♦ 15 years for a program leading to a bachelor's or master's degree; or
- ♦ 20 years for a program leading to a doctoral or first professional degree.

We calculate the annual loan payment using the average interest rate over a three-year or six-year period ending in the last year of the cohort period: for programs two years or less in length, we use a three-year period, and we use a six-year period for programs longer than two years. The average rate for undergraduate (or graduate, respectively) programs is based on the statutory interest rate on Federal Direct Unsubsidized Loans applicable to undergraduate (or graduate) students for the three- or six-year period.

The Department gets the annual earnings by using the student information, mentioned earlier, that a school reports. We create for each award year a list of students who received Title IV aid and completed the GE program during the cohort period. We also indicate which students we intend to exclude and then submit the list to the school for its review. It may make corrections to the list and challenge the exclusion or inclusion of any students; the burden of proof for substantiating this is on the school. After reviewing corrections or challenges, we provide the school with a final list and submit it to the Social Security Administration (SSA).

The SSA calculates and sends the Department the mean and median annual earnings of students on the final list for whom it was able to match data for the “earnings year,” which is the first of the calendar years in the award year for which the D/E rates are calculated. For example, for the D/E rates that will be calculated for the 2014–2015 award year, the SSA earnings year will be calendar year 2014. When calculating a program's D/E rates, we use the higher of the SSA-reported mean or median earnings. The SSA does not send the Department any individual earnings data or the identity of any students and is prohibited by law from doing so.



## Exclusions

Students are excluded from the D/E rates calculation if

- ♦ one or more of their Title IV loans were in a military-related deferment status at any time during the calendar year for which earnings information was received from SSA;
- ♦ one or more of their Title IV loans have been approved or are under consideration for a total and permanent disability discharge;
- ♦ they were enrolled in any other eligible program at any school during the calendar year for which SSA earnings were received;
- ♦ for undergraduate or graduate GE programs, they later completed a higher-credentialed undergraduate or graduate GE program **respectively** at the same school (see below about students completing more than one GE program);
- ♦ the student is dead.

Students may complete more than one GE program at different credential levels. For example, they might enroll in and complete a one-year certificate program and then enroll in and complete an associate degree program at the same school. To account for this, we attribute the loan debt from the lower-credentialed program to the higher-credentialed program completed. This “rolling-up” of loan debt only happens if both programs are GE undergraduate programs or both are GE graduate programs, and if the higher credential is completed subsequent to completion of the lower credential.

## Draft rates and challenges

We will calculate and send schools the draft D/E rates with the source data used to calculate the annual loan payment. Draft rates are released only to the school; they are not made public.

A school may challenge the accuracy of information we used to calculate a GE program’s median loan debt no later than 45 days after the school is notified of the program’s draft rates. The challenge must provide satisfactory evidence that all or some of the information used to calculate the program’s median loan debt is incorrect. As with challenges or corrections to the student list, the burden of proof for substantiating this challenge is on the school. After the 45-day period and after adjusting for any accepted challenges, the GE program’s draft D/E rates become the final rates.

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### Student exclusions

34 CFR 668.404(e)

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**D/E rates outcomes**

34 CFR 668.403(c)

**Outcomes of the D/E rates measure**

A GE program passes the D/E rates measure if its annual earnings rate is less than or equal to 8 percent **or** its discretionary income rate is less than or equal to 20 percent. The program fails if both parts of this test are met: (1) the annual earnings rate is greater than 12 percent or the denominator of the rate (annual earnings) is zero **and** (2) its discretionary income rate is greater than 30 percent or the income for the denominator of the rate (discretionary earnings) is negative or zero. A program with rates that are neither passing nor failing is in the “zone.”

A program becomes ineligible for Title IV program funds if it (1) fails the D/E rates measure for two of any three consecutive award years for which rates were calculated or (2) has a combination of zone and failing D/E rates for four consecutive award years for which rates were calculated.

We inform an institution through a *Notice of Determination* of a GE program’s final D/E rates whether the program is passing, failing, in the zone, or ineligible; whether it could become ineligible based on final D/E rates for the next award year; whether the school is required to provide student warnings; and, if the program’s final rates are failing or in the zone, how it may make an alternate earnings appeal. The determination is effective on the date specified in the notice and constitutes the final decision of the Department with respect to the D/E rates for the program.

**Transition period calculation**

For several years we will calculate alternate D/E rates that use the loan debt of a more recent one-year cohort of students who completed the program to calculate the annual loan payment (the same earnings information from SSA will be used). As a result, a school may improve a program’s D/E rates in the initial years after the regulations take effect. For example, a school might reduce tuition and fees for the more recent cohort such that there would be a lower annual loan payment amount for the transitional D/E rate calculations.

For a GE program of one year or less, the transition period is the first five award years for which the Department calculates D/E rates. For programs more than one and less than or equal to two years in length, the transition period is the first six award years. For programs longer than two years, the transition period is seven award years. Each of the years for which we issue any D/E rates is included in the transition period whether or not we issued rates for a specific GE program.

During the transition period, if the program is failing or in the zone based on its draft D/E rates, we will calculate transitional draft rates using the median loan debt of students who completed the program in the most recently completed award year, not the median loan debt for the applicable two-year or four-year cohort period. Final rates for the program will be the better of the draft or transitional draft D/E rates.

## Appealing final rates

If a GE program is failing or in the zone, a school may file an appeal to request recalculation of the program's most recent final D/E rates. The appeal must be based on the actual earnings of **all the students** who received Title IV aid and completed the program during the same or a comparable cohort period. The school must use the annual loan payment data used in the calculation of the final D/E rates. The school may obtain alternate earnings data from a survey it conducts of its graduates or from a state-sponsored data system, and would then use the higher of the mean or median alternate earnings for the appeal.

### Using a survey to get earnings data

The Department's National Center for Education Statistics (NCES) has developed an earnings survey, and standards for its administration, that schools can use called the Recent Graduates Employment and Earnings Survey (RGEES). NCES has also developed a *Best Practices Guide* with explanations and examples of how to implement the standards in their collection of graduate earnings.

The appeal must include a certification signed by the school's chief executive officer (CEO) attesting that the survey was conducted according to RGEES standards and that the mean or median earnings figure used to recalculate the D/E rates was accurately determined. The school must also submit an examination-level attestation engagement report prepared by an independent public accountant or independent government auditor attesting that the survey was conducted according to the requirements of the RGEES. The Department may also require additional supporting documentation.

### Using a state-sponsored data system for earnings data

With this method a school must submit to the administrator of each state-sponsored data system used for the appeal a list of all students who received Title IV aid and completed the program during the same cohort period the Department used to calculate the final rates. The school must demonstrate that it obtained annual earnings data for more than 50% of the number of students in the cohort period and alternate earnings data for 30 or more of those students. The school must include with the appeal a certification signed by its CEO attesting that state-provided data were accurately used to recalculate the D/E rates. The Department may also require more supporting documentation.

## Alternate earnings appeals

34 CFR 668.406

Gainful Employment Electronic Announcement #95 - Debt-to-Earnings Rate Alternate Earnings Appeals, October 26, 2016

Gainful Employment Electronic Announcement #105 - Additional Time for Submission of an Alternate Earnings Appeal and to Comply with Gainful Employment (GE) Disclosure Requirements, March 6, 2017

For a complete list of Gainful Employment Electronic Announcements and Dear Colleague Letters, please visit

<https://ifap.ed.gov/GainfulEmploymentInfo/GEDCLandEAV2.html>

### Timing of an appeal

A school must submit notice of its intent to appeal no earlier than the date the Department provides it with its draft D/E rates but no later than 14 days after the Department issues the notice of determination that as a result of the program's final rates, the program either failed or was in the zone. The school must then submit its appeal, including its recalculated rates, certifications, and any supporting documentation, no later than 60 days after the date the Department issues the notice of determination.

When a timely and complete appeal has been submitted, the school is not subject to any consequences (i.e., student warnings and loss of program eligibility) while the appeal is considered. If the Department denies the appeal, it notifies the school of the reasons for the denial and the program's final rates previously issued in the notice of determination will stand. If the appeal is granted, the institution is notified of the recalculated rates, which become the new final D/E rates for the program.

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### GE program warning content

34 CFR 668.410(a)(2)(i)

### *Consequences of failing and zone rates*

For three years after the date of a voluntary discontinuation a school may not (1) reestablish the eligibility of an ineligible program or of a failing or zone program that it discontinued voluntarily or (2) establish the eligibility of a program that is substantially similar to the discontinued or ineligible program. Two programs are substantially similar if they share the same four-digit CIP code.

If a GE program could become ineligible based on its final D/E rates for the next award year, the school must warn students and prospective students. The warnings must contain language specified in the regulations or alternate language subsequently provided by the Department and must refer students and prospective students to, and include a link for, the Department's College Navigator website for information about similar programs.

Warnings to students enrolled in the GE program must:

- ◆ Describe the academic and financial options available to students to continue their education in another program at the school, including whether they can transfer credits (and which credits) earned in the program to another program.
- ◆ Indicate whether, if the program loses Title IV eligibility, the school will continue to provide instruction allowing students to complete the program or will refund tuition, fees, and other required charges.
- ◆ Explain whether students could transfer credits earned in the program to another institution.



The school must provide the warning in writing to each enrolled student no later than 30 days after the date of the Department's notice of determination. **The school must either hand deliver the warning as a separate document or send it to the student's primary email address with the warning as the only substantive content in the email.** If email is used, the school must receive an electronic or written acknowledgment that the student received the email. You may not deliver an initial warning using regular U.S. Postal Service mail or commercial courier service. If a response indicating that the email could not be delivered is received, the warning must be sent using a different address or method of delivery, which could include U.S. Postal Service mail or commercial courier service. A school must keep records of its efforts to provide warnings.

Requirements for delivering warnings to prospective students are similar to those for enrolled students except that the warning must be provided at the point when the prospective student initially contacts the school about the program. Also, schools have the additional options of providing prospective students with a copy of the disclosure template that includes the warning or providing them the warning orally if the contact is by telephone. However, a school may not enroll or register students or have them enter into a financial commitment after receiving just an oral warning. Accordingly, any student who received an oral warning must, prior to enrolling, registering, or entering into a financial commitment with the school, receive a non-oral warning as described above. A school may not enroll, register, or enter into a financial commitment with a prospective student earlier than three business days after it first provides that warning to the student or, if more than 30 days have elapsed since the warning was first given, three business days after an additional warning is given.

In addition to providing warnings directly to students and prospective students, the school must update the disclosure template for the GE program to include the warning within 30 days of receiving notice from the Department that a warning must be provided for the program.

